RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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February 20, 1991 **LETTER 1063**

Feb. 8 DJIA 2830.69; PTI 3194; A-D Ratio -13.68
Feb. 14 DJIA 2877.23; PTI 3195; A-D Ratio -13.15
Dow Yield: 3.48%; Dow P/E: 14.8; DowPow: -151
Dow 200-day MA: 2672; Dow 30-day MA: 2650
Dow Book Value: 1276; PTI 89-day MA: 3164
Percentage of Undervalued Blue-chips: 22%

REFLATION ALL OVER AGAIN? Doozie is a slang word generally applied to anything big or outstanding. The word Doozie comes from the famous Duesenberg car of the 1920s, a car that was considered superior, the best, the most expensive (the Duesenberg, by the way, was an American-made auto).

So let's give Wall Street credit -- any way you look at it, this is one doozie of a rally. Cries of a "new bull market" can be heard across the land, and I suggested in many previous Letters that this was just the kind of phenomenon which we were to expect. I also warned that this would be a long, difficult, deceptive bear market and that it would have many moves that might go down in history as "mini-bull" and "mini-bear" markets -- all, however, occurring within the context of a major or primary bear trend.

Nevertheless, you can't fault the rally. And I'll say this for it -- I can't remember more than three or four times since the mid-1940s when there was so much panic and hysteria to get out of cash and into stocks. I mean, suddenly, everyone wants stocks. I've already dubbed it the "Buy me anything, but buy -- rally."

Technicians have already dissected and OK'd the advance, noting the big buy signal on the 10-day advance-decline data, the broad breadth surge, the Dow moving above its 200-day moving average, the Averages all moving up in gear, etc. The rally looks good on all counts except one -- stock values.

So what's behind the advance? Obviously, one item has to be changed perceptions. Four months ago, investors' sentiment was all darkness and gloom. Today, your local broker or advisor is proclaiming a bull market. Perceptions on Wall Street can change in a few weeks. Perceptions can also differ from reality, but it seems to me that, right or wrong, the market's "new" perceptions run something like this:

(1) "The war is progressing far better than anyone thought possible, and even the ground war will probably be a lot easier than anyone thinks (actually, Saddam is now putting out peace feelers). Furthermore, Saddam's army is proving to be a 'paper tiger,' so what was all the fuss and fear about?"

(2) "The Recession will also turn out to be a paper tiger. On economics, Mr. Bush will be right for once -- the recession will be short and shallow. So what are we worried about? Let's get out of cash and into the stock market before the Dow crosses 3000. This so-called recession will be history by summer."

(3) "The Fed goofed earlier in that it made credit far too tight. Now Greenspan's job is on the line. When the Fed finally recognized that the economy was in a nosedive, it panicked and stepped on the monetary accelerator. Down went Fed funds, down went the discount rate, and adjusted reserves rose at an unbelievable rate. In the past when the Fed turned up the heat, the market and the economy always responded. If it worked then, why not now?"

The essence of any market advance is the market's willingness to PAY MORE for projected future earnings. The big "kicker" in any market rally then is the price/earnings ratio -- or how many times the market is willing to pay for earnings (or the perception of future earnings). Referring to the current market, investors have been rapidly increasing the amount they are willing to pay for tomorrow's earnings. If tomorrow's earnings are higher, then all will be well. If they turn out not to be higher, then the market will adjust (usually violently down).

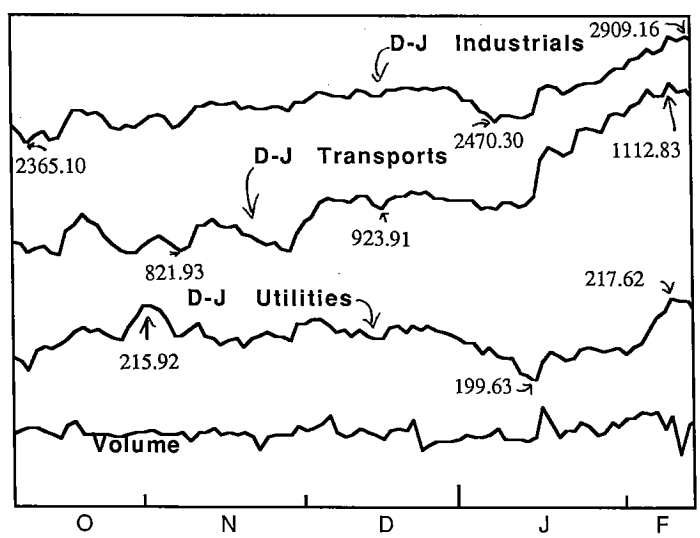
Are the "new perceptions" (1, 2 and 3 above) fated to be the real story? Or could the stock market's new perceptions be just plain wrong? The fact is that the stock market is not usually wrong about the big picture, and therefore I have to label the action since October as a "mini-bull market" occurring within the larger context of a primary bear market.

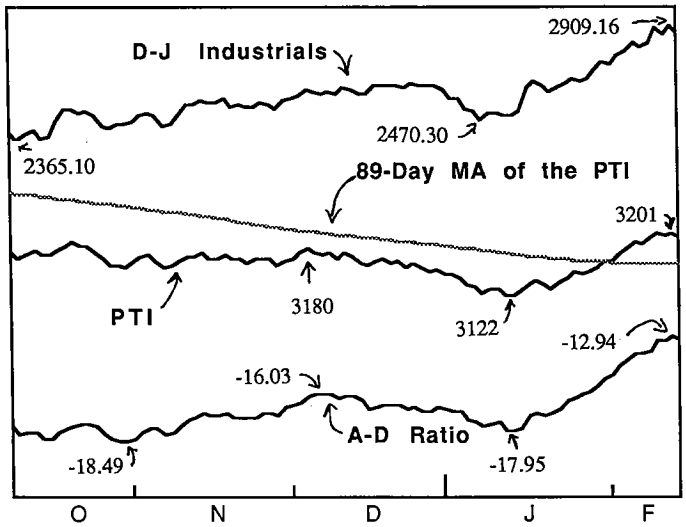
Yes, this kind of action has happened before. My suggestion is (to those of you who own my chart books of the D-J Averages), go back and study the action following the bull market top of 1966. The market battered both the bulls and the bears for years afterwards (remember the speculative explosion of 1968?), and it wasn't until 1973-74 that the bear finally battered the stock market to its knees.

One theory of what's happening now is that the new liquidity being pumped in by the Fed is going into the stock and bond markets, rather than into the economy. That's just a theory, but it's an interesting one and very probably a valid one.

Furthermore, there are some major differences between previous recessions and this one. This time the banks are in trouble and are reluctant to lend. This time the S&L drain on the nation's finances are huge. This time there's an expensive war going on. This time the dollar is sinking. And this time the federal budget is totally out-of-control.

One of the most basic problems in the economy was described in an issue of *Business Week* two weeks ago: "Consumer spending accounts for roughly 70% of GNP. And consumers may hold the key to any recovery. The trouble is households are in sad shape. Real incomes are falling, debts are overwhelming, interest rates are still high, declining home prices are eroding household wealth, and the country is at war."





To all that the market's obvious answer is "Yeah, so what! " And, of course, that's what makes the market so fascinating. Today, in the face of a recessionary economy, Wall Street has obviously been marching to the beat of a different drum.

RUSSELL OPINION: My own opinion continues to be that we've been witnessing a dramatic and powerful bear market rally.

I also think that with this advance, the Dow October low of 2365.10 may be "sealed" in place for quite some time (maybe until the end of this year or beyond).

My best guess is that from wherever this advance ends, that ending will mark the upper limits of a wide trading range. In other words, I believe that following the termination of this advance, the market will lapse into an extended and rather frustrating trading range.

BULL AND BEAR MARKETS: Over the past few weeks I've received many calls from subscribers all asking, "Is this a new bull market?" Unfortunately, I just didn't have time to explain the whole situation to each caller, much as I would have liked to.

But here goes. Once a bull market tops out, and the bull market which began in 1974 did top out in late-1989, then a primary bear market takes over. Now this concept is crucially important -- just as a bull market goes to completion, the bear market will also go to completion. In other words, the bear trend will continue through hell and high water, through rallies and declines, through wars and spates of pseudo-prosperity, through Fed rate cuts and Presidential promises -- until the market finally declines to a true bear market bottom.

Let me repeat this so there will be no misconceptions -- the primary bear trend may be interrupted, it may be extended, it may be fought against by the Fed and Congress, but it will continue, irresistibly, until the bear is exhausted.

It is this concept of INEVITABILITY that is the single hardest thing for investors to understand or accept. "But what would the Fed have to do to trigger a new bull market?" I am asked. And I answer, "Once the primary trend turns down, the Fed can stand on its head, the President can announce a new boom, Congress can pass a hundred new spending laws, but none of these will turn a bear market into a bull market." Once the primary trend reverses from bull to bear or bear to bull, the new trend is set. And the new trend will go to conclusion. Bull markets end in only one way -- exhaustion. Bear markets end in only one way --exhaustion.

To recount a bit of recent history, we saw the way the great 1974-89 bull market ended. It ended in exhaustion. The bull market had lasted 15 long years. The yield on the Dow dropped below 3%. Speculation was wild, rumors were rampant, the public was buying stocks and mutual funds with wild abandon. Michael Milken and his friends were leveraging companies to the tune of tens of billions of dollars. The percentage of NYSE blue-chip stocks that were undervalued declined to a mere 12%. Margin accounts on the NYSE hit an all-time high, volume topped out at record levels, the Dow surged to better than twice its book value, and economists were promising that "there would never be another recession." That's how that spectacular 1974-89 bull market ended. The market had fully discounted the very best that could be seen ahead -- it couldn't get any better.

Next, how will this bear market end? The most important indication of any bear market's end is blue-chip stocks selling at great value (actually, they'll sell below known value). At or near the final bear market bottom the Dow will yield better than 6% and the price/earnings ratio for the Dow will be around 6 to 8. Wall Street will be hated, the public will be battered and sitting on the sidelines. Margin accounts on the NYSE will be perhaps 15% to 25% of their level at the bull market highs. Volume will be greatly diminished. Middle-tier stocks will go begging. There will be literally no market for the "cats-and-dogs," and the brokerage community will be decimated (far more so, believe it or not, than it is today).

So that's what a real bear market bottom looks like. Was any of the above evident at the recent October low at Dow 2365.10? I leave it to subscribers to answer the question.

Another point -- the 1974-89 bull market lasted 15 years. The great bull market topped out on September 5, 1989. Is it logical that the bear market correction of a 15-year bear market would last only 13 months? I don't think it is. To me it's more logical that following the initial bear market decline, the market would come up with a fooler, a fooler calculated to turn everyone bullish again. To do that Wall Street had to produce one doozie of an advance. And that's what it is-- but it's not a new bull market.

By the way, last week two of the D-J Industrial stocks cut their dividends sharply -- GM from 75 cents quarterly to 40 cents, and Goodyear from 45 cents quarterly to 10 cents. Now consider this -- a year ago total dividends on the Dow were **$108.18.** A week ago they were **$103.29.** This week (with the GM and Goodyear cuts) total Dow dividends are **$98.06.** That takes the current Dow yield down to 3.48%, which is historically in the area of tops. And before this bear market is over, you're going to see more dividend cuts -- many more, including more cuts in the Dow stocks.

THOUGHTS: I keep coming back to US finances. The latest count for US Treasury Gross Federal Debt is $3.399 trillion. Exactly one year ago the total federal debt was $2.974 trillion. That means that the US government has added **a record $425 billion** to the total federal debt over the last 12 months. So we're talking about a $1.16 billion addition to the federal debt every day -- 365 days a year. The finances of the US are now wildly, incredibly, unbelievably out-of-control. Last year's and this year's deficits together will add **nearly $1 trillion additional** to the total federal debt.

Interest on the federal debt this year will be roughly $206 billion. That comes to almost $400 million a week! Talk about compounding! Talk about fiscal insanity! I mean we're living it now!

So I ask myself, "Can any currency hold up in the face of this kind of debt-building? How long can this go on before the US is literally unable to sell its sky-rocketing debt? How long can this go on before foreigners will refuse to accept dollars? How long before foreigners will demand that the Treasury issue all its new debt denominated in marks or yen or a gold-backed currency?"

And how long before there is an outright dollar smash? Right now the policy of the Treasury and the Fed is clear. The policy is "OK, let the dollar go down, but don't let it crash -- just let it go down in an orderly fashion."

What we're watching is a once-great currency fading away. So far this means nothing to the average American -- unless he is an

importer or unless he is an American tourist heading overseas or unless he wants to buy a new Mercedes. But mull over this: All history from ancient Rome to the Dutch and Spanish empires indicates that "as a nation's currency goes, so goes the nation."

And again I ask myself, "Is the US stock market dancing on the deck of the Titanic, doing a happy fox trot while its arteries are cut and its blood (i.e., the dollar) goes down the drain?" Honestly, I wish I knew how it will all turn out, but I don't. I do know one thing -- it makes me awfully nervous to see the dollar sinking, sinking, sinking.

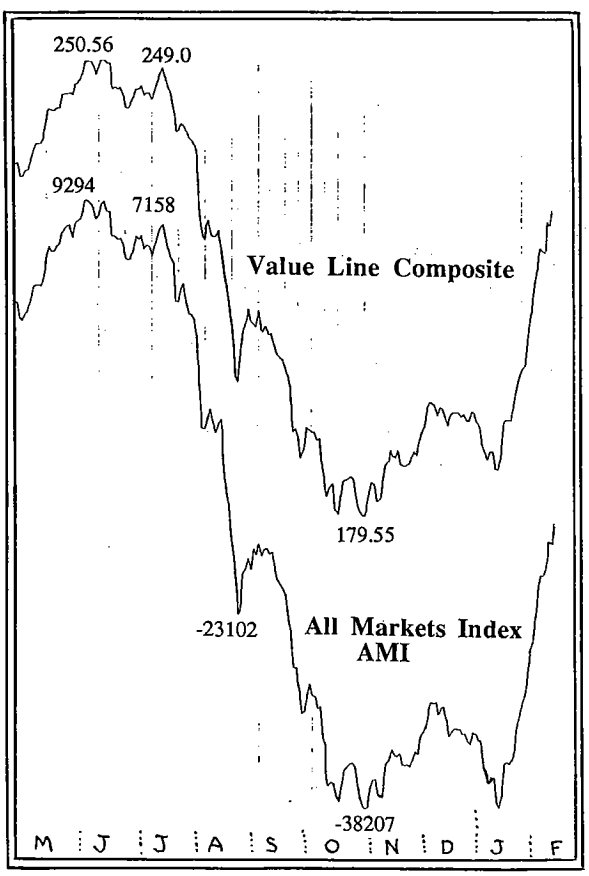
THE DILEMMA: The market clearly believes that it is only a matter of time before the Fed's reflation efforts turn the economy to the upside. On the success or failure of the Fed's efforts rests the basic battle between the bulls and the bears.

But a few analysts are afraid that this time getting out of the recession is not going to be that easy. Said Fred Bergsten, director of the *Institute for International Economics*, "We're in a recession with no tools to get out." What he means is that with endless budget deficits, insolvent banks, a sick dollar and a chronic dependency on foreign capital, Washington doesn't have the tools it needs to reflate us out of this recession.

Some skeptical economists also note that there are no new initiatives in the 1991 Bush budget for fighting the recession. In fact, they feel that the heavily-deficited budget might actually deepen the recession. Time will tell.

AMI and Value Line: Unless you own the 30 Dow Industrial stocks, your stock position probably looks pretty much like the indices below -- both of which I use as a proxy for the average portfolio. The first is the broad Value Line Composite Index, which has now recovered a little better than half of its July to October losses. The second index is my All Markets Index (AMI), which is a composite of the daily advances minus the declines on the NYSE, the NASDAQ and the AMEX.

This is the best advance in both of these in quite some time, but as you can see the July to October losses have still not been recouped.



INVESTMENT POSITION: My position is simple enough. The bear is in the box, which means that I think we've been seeing a rally in a bear market.

For those who got in on the rally, congratulations. My Primary Trend Index (PTI) turned up, and it was a legitimate trade. As for me, I passed. It never bothers me when I miss a move. What bothers me is losing money on a move I should never have been in on.

If you want to make real money, you can't take a piddling position in the market. You've got to go in with a good chunk of your assets. In order to go in with a goodly portion of my cash, I have got to have real conviction. I'll be frank, the only place where I've had conviction, where I've felt comfortable of late, is the currencies -- the German mark, the Swiss franc and the ECU.

Sure you can make money playing bear market rallies, but I haven't got the nerve to jump in big on a bear market rally. I've seen too many people hurt playing those rallies. I judge all market positions in terms of risk/reward.

The dollar has been acting poorly (even in the face of concerted G-7 and Fed intervention). The rate on the three-month Deutsche mark time deposits is now almost 3% above the US 91-day T-bill rate. The German economy remains strong, their trade balance is hugely positive, and their inflation rate is only 2.7% (and they worry about that).

The February 12 *WSJ* states that foreign central banks were buyers of US T-bills at the latest auction. And I ask myself, "When you can get 8.6% on 90-day German government paper and 9.3% on ECU time deposits, why would anyone buy T-bills at 5.9% yields?" I guess (and I'm serious) it would be to keep the US Treasury happy, to keep the US feeling that our foreign creditors are still behind us and rooting for us. Great, but I don't have to keep the US Treasury happy.

So what have I personally done? I've been buying 90-day time deposits in marks, francs and ECUs through the Swiss Bank Corp, and I've also been buying smaller amounts (CDs hedged in marks) through the Mark Twain Bank in St. Louis. So far, the move has been a winner.

Dollar Hits Low Despite Support

9 Banks Intervene But Fail to Arrest U.S. Unit's Slide

By Carl Gewirtz
International Herald Tribune

PARIS — Joint intervention by nine of the world's major central banks Wednesday failed to arrest a slide in the dollar that took it to a record low against the Deutsche mark.

The dollar was trading at around 1.4560 DM[illegible]

I recommended American Barrick (ABX) some months ago. ABX has the largest gold reserves in North America, and the stock really acts very well. Last week I bought more. I like this stock. If you only own one gold stock, this is the one I would recommend (P.S. Even the Value Line service likes it).

BEATING TIME: I wrote about this some time ago, but the principle is so important I want to go into it again. And here it is: anytime you speculate on anything, be it stocks, options, futures, or even if you gamble -- then probably without your being aware of it, you are trying to beat time.

What's that you say? I'm saying that in all forms of investing, speculating and gambling you are (consciously or unconsciously) trying to beat time.

Why do I say that? Here's the answer. If I told you that you were fated to live to be 150, then the only intelligent thing for you to do from an investment standpoint would be to buy an assortment of the safest interest-bearing vehicles --vehicles such as zero coupon T-bonds, German government bonds, Swiss bonds, some top-rated bonds issued by the world's most powerful corporations.

Then what? Then you would sit back, taking no notice of anything that occurred in the markets, and simply compound your money. If you could invest say $5,000 a year at an average return of 8% (no problem today), then in 20 years you would have $228,000. In 50 years you would have $2.86 million. In 60 years you would have $6.26 million (I'm not taking taxes into consideration here). In 100 years -- well, my compounding tables don't go that far, but you get the idea -- you'd be mighty rich, and you'd have done it the safe way.

The idea is this -- if you had TIME on your side, it would make no sense to speculate, trade or gamble. The power ("magic") of compounding would be working for you, and that power would be guaranteed to make you rich -- in the course of time. So why take a chance on losing capital via speculating?

Problem -- no one has an investing life-span of 100 or 150 years. But younger subscribers and those with children might take note of all the above.

My other thought is this: all of us can compound our money, and the question then becomes -- where should we compound?My own philosophy is that I compound my money in safe vehicles unless the situation dictates that it preferable to be in stocks. When is it preferable to be in stocks? When the market is in a definite primary bull market as defined under Dow Theory. In such cases, the ideal time to buy stocks is at the beginning of a bull market when stocks are selling at "great values."

Right now the Dow is selling at well over twice book value, the yield on the Dow is 3.88%, the Dow is selling at 13 times earnings, and only 22% of the blue-chip stocks can be classified as under-valued. This hardly fits the definition of great value. Furthermore, this is not a bull market. Therefore, the preferable place to be is in the safest interest-bearing vehicles. To put it another way, this is not an area where one should think in terms of beating time.

NOTICE: As older subscribers know, I offer two loose-leaf **chart books**, one a chart book of the **D-J Averages** going back to 1885 (daily, a year to each page), and the other a book of the **Dow and the A-D ratio** going back (daily, a year to each page) to 1931. Historical events are annotated on the charts. Both chart books have proved invaluable to institutions, traders, investors and serious students of the market. There's simply nothing else like them in print. The price for the D-J Averages book is $135, the price for the A-D book: $95 (foreigns: $40 extra per book postage).

Both chart books are up-dated each year. **The new 1990 pages are now ready:** their cost is $3 for each page. Back pages are also $3.

NOTES & QUOTES: William Safire, in the Feb. 13 *NY Times,* titles his column, "Cold War II." Safire believes Gorbachev has doubled crossed the US and the world, that he's literally turned Communist dictator again, and that we are now looking at the return of the cold war and the brutal Russian bear. And I ask myself, "Could this be true? Could Gorby have been deceiving us all along? And is Gorby back in bed with the military and the KGB?" And I say (hopefully), "Nah, Gorby is just confused, mixed up, pulling his hair out in trying to deal with problems which are totally beyond his control and understanding." But then I ask myself, "How could he not see that the only way for the Soviets is the free market? How could he not see that? And how ominous that he couldn't. Damn you, Gorbachev!"

Would capitalism work in the Soviets? Do you know what the biggest tourist attraction in Moscow is? It's McDonald's restaurant. McDonald's employs 1200 and gets 27,000 Russian customers every day, three times as many as visit Lenin's Tomb. The lines for McDonald's extend for blocks.

* *

I gasped last week as I heard Secretary Baker talk about Administration plans to rebuild Iraq after the war. A few days later (undoubtedly under pressure) Baker changed it to rebuilding Iraq if Saddam Hussein is gone. Obviously, Baker was telling the Arab world that our war is not against the people of Iraq, only against Saddam. Then why, I wondered, didn't the CIA (in the beginning) just offer the Israelis $500 million to assassinate Hussein. We could have saved billions of dollars and maybe thousands of lives . . . And I wonder, how much is the rebuilding of Iraq going to cost us? It also seems that we'll be keeping a military presence in Iraq long after the war. Is this war a mess or what?

* *

March ushers in the big Arab religious holiday of Ramadan. The allies could be insulting the Islamic world by bombing during Ramadan. Then in April comes the heat. A subscriber (an ex-Air Force meteorologist) sent me a chart showing the average maximum temperatures in Basra, Iraq. In April it's 102 degrees, May 111, June 115, July 118, August 118, Sept. 115. With the heat comes problems. Best this war end soon.

* *

On February 4 President Bush presented his new $1.45 trillion budget. Like every budget that Reagan or Bush has ever presented, this one was in deficit. The Bush budget suggests a deficit of $318 billion in the current fiscal year and "only" $218 billion next year. However, the Bush budget makes some happy assumptions. The Bush budget assumes that the recession will be over by summer and that the war in the Persian Gulf will only cost the US $15 billion (the rest of the bill to be paid by our allies). One critic described is as "a cross-your-fingers, close-your-eyes, and hope-for-the-best" budget.

* *

Germany and Japan (after much arm-twisting from the Bush Administration) have come through with big "promises" of more money (although in both Germany and Japan there is terrific resistance from the populace to providing the US with large sums). Both Japan and Germany (in their Constitutions) are forbidden to enter into military engagements, and the respective citizens of both nations are very happy about that (boy, do times change).

It is also thought France, Tokyo and Bonn want to curry favor with the Arab world, and it is feared that the Islamic world is slowly but surely turning against the US. How this will all work out in the period after the war remains to be seen. But one thing is clear -- none of our European allies (and certainly not Japan) wants to take over the role of policeman to the world. That task, it seems, will be left to the US.

* *

Speaking of budgets, on February 7 Defense Secretary Cheney stated that he saw "continued economic decline" in the Soviets plus "increased unrest." In view of that, he stated that this Administration may reconsider its request for reductions in military spending over the next six years.

* *

There is currently a tremendous demand for dollar currency, the actual money itself. Partly, this demand is due to the huge black market overseas, partly it is due to the desire for actual dollar cash in South America, and partly it is due to narcotic transactions, and finally, the cash dollar is used in the giant US underground economy (swap meets, barter, hoarding, etc.).

One outfit that is prospering mightily from the cash-dollar demand is Crane & Co., of Dalton, Mass. This is the private company that manufactures the paper on which US currency is printed. Last year Crane opened an additional plant in Fort Worth, and they stated that they sent the US government 19% more currency paper in 1990 than in '89. Actually, the "paper" that Crane makes is not paper at all, it is made entirely of linen and cotton. Crane will soon be making a new kind of paper with a metallic thread running through it which will thwart counterfeiters.

* *

Here's a prediction that I can guarantee. The American standard of living is heading down. Why? Because when you spend what you haven't got, sooner or later that borrowing has to come out of something or somewhere. And in the 1990s the cost of borrowing is going to come out of our standard of living.

As proof of what's happening today, I include below a montage of clippings all taken from recent newspapers. In cities, municipalities, counties and states across the nation, it's cut-back time. Everyone except the federal government is running out of money. The federal government can't run out of money -- they manufacture it. The world sees this and it takes note of it -- which is why the dollar is in a horrendous and continuing bear market.

Lines of Jobless Grow as Benefits Staff Shrinks

By STEVEN A. HOLMES

STERLING HEIGHTS, Mich., Jan. 31 — At 7 A.M. a full moon was shining down on Tim Peck as he stood outside an unemployment office trying to ward off the bitter cold and his rising anger.

Seven weeks after he was laid off from his job as a truck driver, Mr. Peck had yet to receive his first unemployment benefits. Several calls to the unemployment office went unanswered or brought a busy signal. So despite ...

"I'm going to grab someone by the throat," Mr. Peck said as he stomped his feet and clapped his hands to keep warm.

state officials have scaled back the staffs at the unemployment offices. But now, as the recession has taken hold, the offices are being overwhelmed wi...

Cries for Help Go Unheeded

■ State and local governments are on the edge of a fiscal abyss. Much of the country is becoming meaner and harsher for those desperate fo...

By SC... TIM...

...stories ...uget num... ...ounty, a severely ...omeless young man ...phantom voices as he sits ...

Cuts After Decade of Cuts: Governors Grim at Meeting

By MARTIN TOLCHIN

WASHINGTON, Feb. 3 — People who have been attending the midwinter meetings of the nation's governors for years cannot remember a bleaker assessment of the states' financial condition than the one they heard this weekend.

The governors, who spent the la... decade lamenting cutbacks in F... aid, said they were so beref... when the current rec... that they now fa... budget deficits ... services, in... progra... the ...

...after a private luncheon the governors. "We ... grams that they ... tures feel cor...

Mr. ... wor...

...ncern ...erfinance ... Mr. Sununu's ..., "He was very ... was echoed by Gov. ...eld of Massachussets, a ...an, who said, "People were ...ed they might be trying to sell us ...pig in a poke."

...82 ...ost gone ...uding cuts," ... of New York ...ashington, said to... ...re already at the bone.

Discussions of state fiscal problems dominated the meeting. "The recession is driving these budget deficits," said Mr. Johnson of the New York State office. "Forty governors have not engaged in gross mismanagement simultaneously. The lion's share of the gap is a revenue falloff."

But the recession has also meant more people on Medicaid and welfare and more people receiving unemployment insurance. And in recent years Washington has directed the states to spend their own money on a wide variety of programs, especially those involving health and the environment.

Paying for New Programs

Governors seek Bush's help for 'unprecedented' deficits

Forty states financially ill, and not a doctor in the house.

* *

Three states accounted for 53% of all the population growth of the 1980s -- California, Florida, and Texas. California's 30 million people are now equal to 21 other smaller states' populations combined . . . In the past decade, the US Asian population is up 80%, Hispanics up 40%, blacks up 14%, whites up 7% . . . Today only 25% of US households are the old-fashioned mom, pop and kids. The rest are singles, divorced, you name it.

* *

The movies have always reflected the American psyche. For instance, in 1932 during the depth of the Great Depression, Hollywood produced both Frankenstein and Dracula. Two years later King Kong arrived. Those movies reflected the fear that was a product of the times. During the Depression people could relate to the horror.

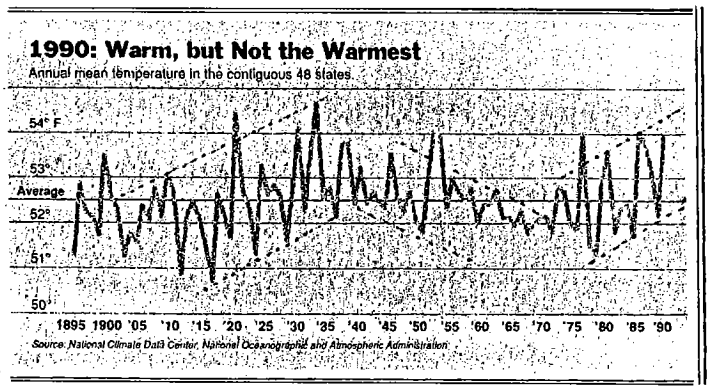
What about today? Today, according to the *New York Times* (Feb. 3), "Sociopaths sell." The article goes on to say that the hot item today is "stories like the horrifying accounts of children who kill their parents or parents who abuse their children." What's going on? It seems that Americans have become fascinated with a new form of horror. So it's "Good bye Frankenstein, hello to your friendly neighborhood murderer." By the way, the new "hot" movie coming out is "The Silence of the Lambs." It is about a serial killer.

* *

I've lived in California since 1961, and I've never seen anything like it -- and I'm talking about the drought. The first year I moved out here it rained during the winter day after day for six weeks straight. And I thought, "This is what it's like in sunny California?" But things change. We've had dry weather for the last five years, but this year is the worst. We've had only one real rain in San Diego in the last eight months. Reservoirs are now two-thirds empty, it's a gathering disaster.

* *

This is a chart showing annual US mean temperature going back to 1895 Believe it or not, the trends can be shown in channels. From 1895 to 1935, the trend was to warming weather. From 1935 to around 1970, the weather cooled down. Then around 1979, the channel turned up again. We're in the warming channel now. How high will it carry this time? We'll find out over the next decade.


1990: Warm, but Not the Warmest
Annual mean temperature in the contiguous 48 states.
54° F
53°
Average
52°
51°
50°
1895 1900 '05 '10 '15 '20 '25 '30 '35 '40 '45 '50 '55 '60 '65 '70 '75 '80 '85 '90
Source: National Climate Data Center, National Oceanographic and Atmospheric Administration

Note that the great dust bowl of the '30s occurred within the upper end of the last warming channel.

* *

Farms use 85% of the water in California, while households use a mere 11%. So if residential housing cut its water usage in half, it wouldn't really help that much. Among other crops, the $18 billion California agricultural business grows pasture, alfalfa, cotton and rice, none of which is naturally suited to this state. In fact, incredibly, more water is used growing just the alfalfa crop than is used by all the people who live in the state.

* *

With the majority of states running deficits and many cities in deficits, the quality of credit in the municipal bond field becomes increasingly important. The muni bond sector is huge -- valued at about $800 billion, better than three times the size of the junk bond market. Last year was the third worst year on record (in terms of dollar losses) for muni bonds. In 1990, 91 muni issuers defaulted to the tune of $1.3 billion, admittedly a small number in terms of the total picture. But market-watchers are talking about a possible muni bond crisis, in view of the number of states and cities in trouble. The states alone face total deficits of above $30 billion. Russell comment: I have always advised buying muni bonds rated AA or better, and if a bond has to be insured, I don't want it. The best muni bonds are "escrowed to maturity," which means that they have US government paper behind them. The escrowed bonds are always AAA rated.

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Every week or so I receive a call from one of the "big boys." By big boys I mean market movers, investors or traders who take HUGE positions in the market (often in the tens or even hundreds of million of dollars worth of stock). To a man (sorry, to a person), these are highly intelligent guys. They are aggressive, curious, often loners, and basically very democratic. They are mainly interested in one thing -- do you know anything that can help them?

I often wonder what drives these individuals. All of them have enough money to live comfortably (to put it mildly) for the rest of their lives. What makes them tick? I think what makes them tick is (1) the excitement of the game, (2) the quest for power, (3) the desire for publicity and approval, and (4) the need to constantly prove themselves.

It's funny, I can relate to all four reasons, but I couldn't live that way. I couldn't sleep knowing that the market could run my account up or down a million bucks or more at the opening. I couldn't sleep wondering whether the market was going to render me a genius or a fool. I guess I'm just a sissy.

END OF THE WAR? This is a tough Letter to write (aren't they all?) because so much of today's market action is based on news.

On February 15 (I heard this at 3:30 AM in the morning while on my treadmill) Iraqi radio announced that Iraq was ready to pull out of Kuwait. But a little later the Revolutionary Council announced conditions. Ah, those conditions. Bush said the message was a "cruel hoax," that nothing new was included in the broadcast, and that the war would go on.

In fact, Bush has appealed to the Iraqis to revolt and overthrow Saddam. I don't think this is going to happen. The reason -- according to the *Washington Post* 15,000 crack troops guard Saddam day and night. So it would take a major revolution with backing by the Iraqi military to get rid of Saddam. I just don't think that's going to take place. I think the real resistence to Saddam within Iraq is too small and moreover it is totally unorganized.

So far, the best weapon Saddam has had in this war has been TV and radio. Was Saddam putting out "feelers" on February 15? Was he feeling around to see if there was any weakness in the allied position? Was he trying to muster additional support from the anti-war elements ("Gee, Saddam wants peace, why don't we go for it?")? Was Saddam getting nervous about the possible start of the ground war? Was he simply playing to the Muslim world ("Those monster Americans, they just want to bomb Iraq out of existence!")?

At this point, I can only say, "Who the devil knows what Saddam is doing?" We know two things about Saddam for sure. We know he is a liar and an expert propagandist. So for my part, I don't know what to make of the statements coming out of Iraq.

Ideally, the best thing that could happen would be an assassination of Saddam or at least an internal overthrow of his regime. But what if he simply does pull out of Kuwait? Then what? Saddam is still in control, he still has impressive military capabilities, the allies would have to stay in Saudi Arabia as watchdogs. To me, a simple Iraqi pullout of Kuwait with Saddam still in power would be a mess, not a victory.

THOUGHTS: I've been talking to a slew of newspaper people lately (I guess because the stock market has been news lately). It's very difficult talking to most of these people because the majority are basically reporters (and maybe good reporters) but they have little or no knowledge of the markets, and they have never taken the trouble to study the markets.

Many times I'm asked, "Can you give me a short description of what the Dow Theory is all about?" And my answer is, "I've spent years studying the Dow Theory, I've read all the basic books on the Dow Theory, and I'm still learning about it. But I can tell you this. The true crux of the Dow Theory has to do with *buying stocks when they are cheap on a statistical basis and selling stocks when they are expensive on a statistical basis.*"

Charles Dow talked mostly about buying values and very little about the action of the Averages. In fact, he almost never mentioned the confirmation principle, a concept that was really put forth by William Hamilton, Dow's successor as editor of the *Wall Street Journal.*

Later in the 1930s, Robert Rhea, a great student of Dow Theory, wrote at great length about market action in his "Dow Theory Comment" letters. Finally, George Schaefer added to the Dow Theory with his technical innovations. Schaefer noted that the market of the 1970s was far, far bigger than the market of the '20s and '30s. He also held that because of the market's greater size and because of the greater participation by the public (plus the fact of almost instantaneous communications) that there could be many false signals given by the Averages.

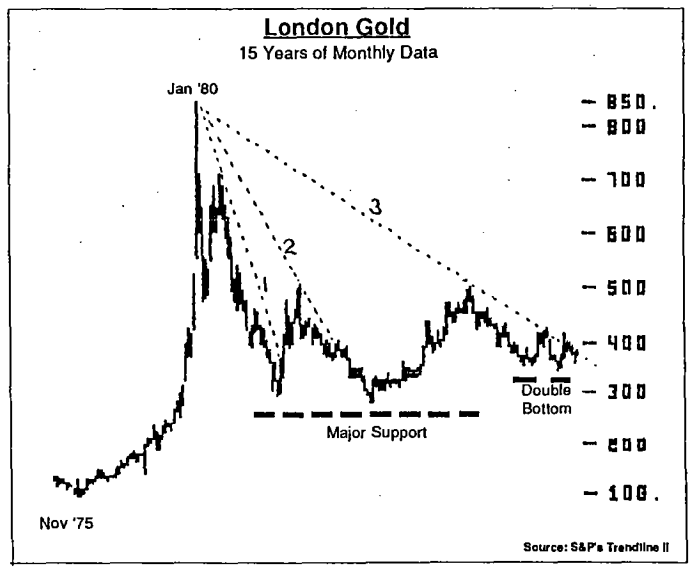
These were signals, Schaefer believed, that would prove deceptive and costly to those who mechanically followed the action of the Averages while ignoring the much more important Dow Theory concept of buying great values and selling those items when they became overvalued.

Schaefer was my mentor during the '40s and '50s, and he taught me a great deal about the market's primary trend. I have never, before or since, met anyone who possessed such a grasp of the primary trend of the market (the primary trend, of course, is the great fortune-maker and fortune-breaker of Wall Street).

GOLD: The classic gold divided by silver pushed (incredibly) over 100 recently, meaning that an ounce of gold would buy over 100 ounces of silver. I've never been a silver fan, but I'll admit that I never thought I'd see that kind of ratio.

This is a chart that I published back in Letter 1053. It's a monthly chart of gold going back to 1975. I've drawn three "fan-lines" from the high, and according to classic technical theory when the third descending fanline is penetrated to the upside, the main trend turns UP. The third fanline was reversed last October. Since then, gold has done nothing, but much as everyone hates it, gold has also not broken below the double bottom shown on the chart.

Gold should be part of every diversification program. These days nothing is "for sure." Well, a few things are. The US government will continue to tax and spend, US living standards will continue to decline, and gold will continue to be the only real money. Gold under 400 is, in my opinion, a bargain, particularly in the face of federal deficits of $1.1 billion a day.



LATE NOTES: February 13 and the amazing "buy me anything advance" has produced new record highs in both the S&P 500 and the NYSE Composite. Pretty darn impressive. Yet the fact is that I don't think I've ever seen a more complicated situation than the present one. My PTI, as you can see on the page 2 chart, is in an "up, up and away" mode.

I stick pretty close to classic Dow Theory, and here we have the D-J Industrial Average within shooting distance of its record (2999.75) high, yet the Transportation Average is (as of this writing) a whopping 425 points away from its own 1989 record high of 1532.01. So what happens -- a new Dow high with a flagrant Transport non-confirmation? A fake-out with the Dow failing to go to a new high and then trouble? Or just plain higher prices? As I've said so many times before, they don't run the market for Richard Russell's benefit. If they did, it would make it a lot easier market to read. This is just one of those situations where I'm content to sit back and let the market tell its own story.

But here's what I do see. Wall Street appears quite bullish now, and the funds and institutions have rushed into this market with almost frantic abandon. Yet the Averages I give most credence to (the D-J Industrials and Transports) are out of gear, and over the last few days the Transports are starting to lag noticeably -- even when the Dow is rallying. It's exciting all right, but excitement never made any money for me; only calm, intelligent investing did.

NEXT MAILING: March 6